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CENTRAL INTELLIGENCE AGENCY
Directorate for Intelligence

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Japan: Economic Outlook

Committed to fiscal austerity, Tokyo publicly maintains that continuing an expansive monetary policy and maintaining low inflation will revive Japan's domestic economy in FY 1982 and eventually trim the trade surplus. The government officially forecasts that GNP should grow 5.2 percent in FY 1982 compared with 4 percent in FY 1981. [redacted] Assuming the world economy continues on a slow recovery path and oil prices remain stable, we believe that GNP could probably expand about 4.3 percent, with domestic demand contributing as much as 3 percentage points to this growth. [redacted] 25X1

The Government Forecast

Officially Tokyo is looking for an upswing in domestic demand to boost GNP growth in FY 1982 and reduce dependence on exports. The star performers in the government's scenario are consumer spending and housing construction. In public, EPA officials argue that consumers should spend more because of slowing inflation and the 7.8-percent wage increase secured by labor unions in major industries this fiscal year. Tokyo asserts that residential construction will rebound in FY 1982 in response to slipping interest rates. [redacted] 25X1

In the foreign sector, the government acknowledges that a large current account surplus is unavoidable in FY 1982. EPA estimates the current account surplus will reach $12 billion, compared with $9-10 billion in FY 1981. [redacted] 25X1

This memorandum was prepared by [redacted] *Japan Branch, Northeast Asia Division, Office of East Asian Analysis. Information available as of 4 January 1982 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Japan Branch, Northeast Asia Division, OEA,* [redacted]

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NSC review completed.

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The Budget Proposal

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[redacted] In his drive to balance the budget by FY 1984, Suzuki (with the strong help of the Finance Ministry) has held the budget for total general accounts expenditures in FY 1982 to a 6.2-percent increase. Public works spending will remain flat. Although additional allocations to the Fiscal Loan and Investment Program to aid housing and small businesses were approved, these increases were slight. [redacted] 25X1

Faced with a growing trade imbalance, a sluggish domestic economy and falling tax revenues, Suzuki may be forced to consider measures to soften the deflationary impact of the budget. Because of his political commitment to a government reform program, we do not believe he will abandon his philosophy of fiscal austerity. One alternative is to relax monetary policy further. While helping the housing industry, this option could slow yen appreciation, enhance the competitiveness of Japan's exports, and worsen the trade situation. Another possibility is to advance the time schedule for FY 1982 general accounts expenditures to stimulate domestic activity. [redacted] 25X1

[redacted] 25X1

The CIA Forecast

Since Suzuki does not appear ready to boost the level of public spending, we believe that GNP growth will be well below the 5.2-percent official target. We estimate overall growth could reach 4.3 percent, up from 3.5 percent in FY 1981, if the current relaxed monetary policy continues. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Japan's domestic economy will show moderate gains. Consumer spending should increase as real wages rise because of lower inflation and yen appreciation. Nonetheless, labor's bargaining power during the coming spring wage offensive will be tenuous because of continued high unemployment, excess capacity and falling profits in many industries. We expect unions in major industries to gain a 6- to 6.5-percent wage settlement, below the government target of 7.0 percent. [redacted] 25X1

Current low interest rates and easy credit should encourage a recovery in investment and construction, but again our estimate falls short of the official forecast. Firms, especially non-exporting industries, will remain cautious in rebuilding their inventories and expanding plant operations. Housing construction could take a hefty jump to around 6 percent, but more stimulus in the form of public loans for home mortgages would be necessary to achieve the official target of 10.4 percent. [redacted] 25X1

Roughly one-third of FY 1982 GNP growth should come from the foreign sector, a significant drop from the almost 80 percent contribution this year. As the yen appreciates, exports will slow to an 8-percent annual increase, down from 11 percent in 1981. Imports, made cheaper by the appreciation, will increase by 4 percent compared to a 3-percent decline this year. Even so, the current account surplus will remain large and should exceed $18 billion. [redacted] 25X1

An Alternative Outlook

Our forecast assumes that world economic recovery will continue on a slow but steady path throughout FY 1982. The yen exchange rate, strengthened by the surplus, should appreciate somewhat. Uncertain about these assumptions, we also considered the case of a sustained OECD recession in 1982. Tokyo would term this scenario a "worst case" approach. If world trade expanded only 3 percent in 1982 Japan's GNP growth would fall to less than 4 percent. Corporate investment would slack off in response to weaker foreign demand and consumer spending would slow. Export growth would drop by almost 2 percentage points while imports, mainly raw materials and mineral fuels, would slip a little, as firms slowed inventory accumulation. Because of export losses, the current account would fall $4 billion, to $14.5 billion. [redacted] 25X1

[redacted] 25X1

Table 1

Japan: Comparison of FY 1982
Economic Growth Forecasts

	CIA Model Forecast FY 1981	CIA Model Forecast FY 1982	Official Government Forecast FY 1982	JERC* Forecast FY 1982
	(Percent change from previous year, in constant prices)			
GNP	3.5	4.3	5.2	4.1
Consumption	0.1	2.6	3.9	3.5
Corporate Investment	-0.4	4.3	7.7	6.0
Residential Construction	2.1	5.9	10.4	4.2
CPI	4.4	4.1	4.5	3.9
WPI	.4	-0.6	3.0	0.6
	(Billions of US$)			
Current Account Balance (CY)	7.0	18.5	12.0	24.6
Yen Exchange Rate	224.1	212.5	219.0	197.5

*Japan Economic Research Center

25X1

Table 2

Japan: 1982 Economic Growth Forecast

	CIA Forecast	CIA Scenario #1	CIA Scenario #2	CIA Scenario #3
(Percent Change from Previous Fiscal Year, in Constant Prices)				
GNP	4.3	4.4	3.9	4.0
Consumption	2.6	2.8	2.5	2.7
Corporate Investment	4.3	4.3	4.1	4.1
Residential Construction	5.9	5.9	5.8	5.9
CPI	4.1	3.3	4.2	3.4
WPI	-0.6	-2.5	-0.5	-2.4
Contribution to GNP:				
Domestic Demand (percentage point)	3.0	3.2	2.9	3.1
Foreign Demand (percentage point)	1.3	1.2	1.0	0.9
(Percent Change from Previous Calendar Year, in Constant Prices)				
Exports of Goods	8.3	8.1	6.4	6.2
Imports of Goods	3.7	3.2	3.6	3.1
(Billions of US$)				
Current Account Balance	18.5	20.5	14.5	16.7
Fiscal Year Assumptions:				
World Imports (less Japan)	4.6	4.6	3.4	3.4
Exchange Rate	212.5	202.5	212.5	202.5

Scenario #1: Yen appreciation proceeds at a faster pace

Scenario #2: World imports, excluding Japan, slow down.

Scenario #3: Assumptions from scenarios 1 and 2 are combined

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